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TO: Supervisor Michael D. Antonovich, Mayor  
Supervisor Hilda L. Solis  
Supervisor Mark Ridley-Thomas  
Supervisor Sheila Kuehl  
Supervisor Don Knabe

FROM: John Naimo *[Signature]*  
Auditor-Controller *[Signature]*

SUBJECT: **AUDIT OF THE COUNTY GENERAL FUND'S MUSIC CENTER  
BUDGET (Board Agenda July 7, 2015, Item 3)**

On July 7, 2015, your Board of Supervisors (Board) instructed the Auditor-Controller to conduct an audit of the County General Fund's Music Center budget to review the use of County funding provided for Music Center operations. We have completed our review of County funding for Fiscal Years (FY) 2012-13, 2013-14, and 2014-15.

The County has a long-standing relationship with the Performing Arts Center of Los Angeles County (PACLAC), a private non-profit corporation, to operate the County-owned Music Center facilities. The County budget provides financial support to PACLAC for building and grounds maintenance, utilities, usher services, security, insurance, housekeeping, and miscellaneous administrative support services. County funding to PACLAC for FY 2014-15 totaled \$25 million, approximately 40% of PACLAC's total expenditures of \$62.4 million. The \$25 million included \$1.1 million in pass-through arts funding that PACLAC paid to the Los Angeles Opera and the Los Angeles Philharmonic. The County also provided an additional \$5 million to PACLAC for operating Grand Park, which was not included in our audit scope.

Our review included interviewing PACLAC management and staff, reviewing PACLAC's records relating to County-funded expenditures, and evaluating whether the expenditures complied with the various Music Center related leases and agreements between the County and PACLAC. We also evaluated PACLAC's compliance with requirements in the leases/agreements that relate to County funding.

### **Results of Review**

Overall, PACLAC's accounting records indicate that expenditures for County-funded services exceeded the total amount the County paid. However, as noted throughout this report, it is not clear if all of the expenditures met the criteria for County reimbursement. For example, the County has been paying PACLAC for costs such as insurance and overhead that, according to the leases and agreements, should be borne by PACLAC. In addition, we noted various types of expenditures charged to County-funded operations, such as legal fees, guest parking, etc., that do not appear to meet the criteria for County funding. We also noted that PACLAC has not been complying with various provisions of the leases/agreements, and the County has not been asking them to comply. We have recommended that County management improve its oversight of PACLAC's use of County funds, and that the County amend leases/agreements with PACLAC to clarify the types of expenditures the County will fund.

The following are examples of the issues noted in our review:

- **County management needs to determine what budgeted line items the County will pay for, and ensure leases/agreements with PACLAC accurately reflect the agreed-upon funding.** For the three fiscal years reviewed, the County approved and paid a total of \$5.8 million to PACLAC to cover PACLAC's budgeted costs for Administrative Overhead, Insurance, and First Aid, but, according to the leases/agreements, the County is not obligated to reimburse PACLAC for these costs. PACLAC management indicated that the County verbally agreed to reimburse PACLAC for these costs, and that approximately half of the insurance (i.e., \$1.6 million) was for property insurance, which PACLAC procured on behalf of the County. However, there is no written record of the agreements.
- **County management needs to analyze specific costs that PACLAC charges to County-funded operations to determine if they are eligible for reimbursement.** The leases and agreements with PACLAC indicate that the County will reimburse PACLAC for their costs to provide custodial, groundskeeping, ushering, security, and general facilities maintenance services, but often do not specify what types of costs would be reimbursed. During the three fiscal years reviewed, we noted various costs that PACLAC charged to County-funded operations that appear questionable, such as telephone and communication services (\$96,900) and legal fees (\$135,800), which, per the leases/agreements, the County is not required to pay.
- **County management needs to determine if the County should reimburse PACLAC for a portion of their administrative overhead.** As noted above, based on the leases and agreements, the County has no obligation to reimburse

PACLAC for their administrative overhead expenses. If the County decides to reimburse PACLAC for a portion of their overhead, County management needs to establish an appropriate method for determining the amount of overhead to be charged to the County. In addition, PACLAC's overhead during the three-year period reviewed included expenses that may not be appropriate to receive taxpayer funding, such as search firm fees (\$234,000), business/employee meetings (\$102,000), catering (\$53,000), and business gifts (\$7,000).

- **County management needs to determine the appropriate timing of payments to PACLAC and consider amending relevant agreements accordingly.** The County pays PACLAC its entire annual budgeted amount at the beginning of the fiscal year, not on a monthly reimbursement basis as the agreements require. Although an annual Board resolution authorizes the County to make advance payments to PACLAC, it is not required by the agreements between the County and PACLAC.
- **PACLAC management needs to ensure annual budgets submitted to the County reflect actual expected costs to provide County-funded services.** The annual budgets that PACLAC submits to the County are based on the prior year's budget adjusted for cost of living increases and other special increases such as minimum wage increases, and therefore may not be good indicators of actual costs.
- **PACLAC management needs to revise their accounting methods to enable the tracking of individual expenditures to County funding.** PACLAC's accounting records for County-funded operations do not specifically identify which expenditures were paid for with County funds and which were paid for with funds from other sources. As a result, we were sometimes unable to determine if a specific expenditure was paid for using County funds.
- **County management needs to create an agreement with PACLAC specific to Facility User's Fees (Facility Fees) and require PACLAC to obtain County approval before spending the Facility Fees.** The Board approved the implementation of a 5% Facility Fee on all tickets sold at the Music Center, and required the County to create an agreement with PACLAC specific to the Facility Fees. However, PACLAC and County staff have been unable to locate the agreement. We also noted that PACLAC does not obtain County approval before spending the Facility Fees, and has used or is planning to use \$13 million in Facility Fees to repay bonds used to finance a renovation project.
- **County management needs to request and PACLAC needs to submit solicitation documents and contracts to the County for approval, as required by the leases/agreements with the County.** PACLAC does not submit requests for proposals or contracts to the County for review and approval,

as required by the leases/agreements, and the County has not been requesting these documents.

Details of these and other findings and recommendations are included in Attachment I.

### **Review of Report**

We discussed our report with PACLAC management. PACLAC's attached response (Attachment II) indicates general agreement with our findings and recommendations. However, we would like to clarify two of our findings referenced in PACLAC's response. For example:

- PACLAC's response indicates that their expenditures for providing County-funded services exceeded County funding, and that the County's intent was to fully fund all Music Center operations. However, as noted above, while we did note that PACLAC's expenditures exceeded the amount the County paid, we also noted that many expenditures did not appear to meet the criteria for County funding. In addition, the agreements with PACLAC indicate that the County will fund only certain operations.
- PACLAC's response indicates that the County has acknowledged that administrative overhead, insurance, and other expenditures described in our report are appropriate. However, our report indicates that the County has no obligation to pay for these expenditures under the current leases and agreements with PACLAC, and recommends that County management determine what level of funding the County desires to provide and update the leases and agreements accordingly.

We thank PACLAC management and staff for their cooperation and assistance during our review. If you have any questions, please contact me, or your staff may contact Robert Smythe at (213) 253-0100.

JN:AB:RS:TK

#### Attachments

c: Rachel S. Moore, President and CEO, PACLAC  
Sachi A. Hamai, Chief Executive Officer  
Patrick Ogawa, Acting Executive Officer, Board of Supervisors  
Public Information Office  
Audit Committee

## **AUDIT OF THE COUNTY GENERAL FUND'S MUSIC CENTER BUDGET**

### **Background**

The County has a long-standing relationship with the Performing Arts Center of Los Angeles County (PACLAC), a private non-profit corporation formerly known as The Music Center Operating Company, to operate the County-owned Music Center facilities. The Music Center's original campus included the Dorothy Chandler Pavilion, the Mark Taper Forum, and the Ahmanson Theatre, and later included the Walt Disney Concert Hall (WDCH). The County has entered into various agreements with PACLAC to operate the original Music Center facilities beginning in the early 1960s. The County also has separate agreements with PACLAC to operate the WDCH. The agreements between PACLAC and the County authorize PACLAC to sublease the facilities to Resident Companies for the purpose of presenting performances. PACLAC currently subleases Music Center facilities to four Resident Companies: Los Angeles Opera, Center Theatre Group, Los Angeles Master Chorale, and Los Angeles Philharmonic Association.

The County budget provides financial support to PACLAC for building and grounds maintenance, utilities, usher services, security, insurance, housekeeping, and miscellaneous administrative support services. County funding to PACLAC for Fiscal Year (FY) 2014-15 totaled \$25 million, approximately 40% of PACLAC's total expenditures of \$62.4 million. The \$25 million included \$1.1 million in pass-through arts funding that PACLAC paid to the Los Angeles Opera and the Los Angeles Philharmonic Association. The County also provided an additional \$5 million to PACLAC for operating Grand Park, which was not included in our audit scope.

### **Scope**

Our audit included a review of funding the County provided to PACLAC for FYs 2012-13, 2013-14, and 2014-15. Our audit scope included:

- Reviewing PACLAC's accounting records to ensure all payments from the County were accounted for;
- Determining what expenses the County should pay for based on leases and/or agreements between the County and PACLAC;
- Testing a sample of expenditures for appropriateness and support; and
- Reviewing how PACLAC spent Facility User's Fees (Facility Fees), which are added to all Music Center tickets sold and are to be used for repair and replacement of furnishings and fixtures at Music Center facilities.

Our audit scope did not include County funding for Grand Park or for capital projects, except as they relate to Facility Fees. Our scope also did not include a review of PACLAC's internal controls. However, we did observe some internal control

weaknesses during our review of documentation supporting how PACLAC used County funding, and noted those weaknesses in this report.

### **Limited Access to Records**

According to the terms of the Music Center 1963 Operating Sublease, the County has the right to audit all transactions relating to the Music Center. It appears the intent was for all PACLAC financial records to be made available to the County upon request. However, during our audit, PACLAC management indicated that they strongly believe that the County only has the right to access their records that are related to County funding, and denied our request for access to other records. As a result, we did not have access to PACLAC's records relating to management of revenue from other sources such as fundraising, or to records relating to PACLAC's expenditures in areas such as education and programming. Therefore, our review was limited to PACLAC operations that are reimbursed by the County.

### **County Oversight and Management**

The County provides a significant amount of financial support to PACLAC, and has a fiduciary responsibility to monitor PACLAC's use of taxpayer monies to ensure they are used for appropriate purposes. Based on our review of the leases and agreements with PACLAC, the County is provided with opportunities for the oversight and monitoring of PACLAC's use of County funding. For example, the lease for the original Music Center campus requires PACLAC to provide the County with an annual accounting of revenue and expenses from the operation and use of the Music Center. However, PACLAC has not been providing the annual accounting, and the County has not followed up to request it. In addition, the leases and agreements require PACLAC to invoice the County monthly in arrears for reimbursement of actual costs, after submitting appropriate supporting documentation. However, the County has been providing advance payments at the beginning of each fiscal year and has not asked PACLAC to provide an accounting of how the monies were spent. We also noted that, as noted in other sections in this report, the County-approved funding has included items that, according to the written leases and agreements with PACLAC, the County is not obligated to pay.

### **Recommendations**

#### **County management:**

- 1. Improve oversight over the Performing Arts Center of Los Angeles County's use of County funds by requiring compliance with the financial accountability provisions of the leases and agreements.**
- 2. Designate staff to monitor the Performing Arts Center of Los Angeles County's use of County funds to ensure spending is for appropriate purposes.**

**Leases/Agreements Between County and PACLAC**

During our review, we noted multiple areas where current practice differs significantly from terms in the leases and agreements between PACLAC and the County. For example, in FY 2014-15, the County paid \$2.3 million to PACLAC to cover expenses for Administrative Overhead, Insurance, and First Aid. While the Chief Executive Office (CEO) approved these expenses as part of the County budget, the County is not responsible for paying for these items in accordance with the leases and agreements between the County and PACLAC. According to PACLAC management, the County verbally agreed to cover these expenses. However, there is no written record confirming the agreement.

During our review of PACLAC's use of County funding, we also noted the following:

- There are numerous leases and agreements between the County and PACLAC, including various amendments. As a result, it's not always clear which version to refer to for specific agreement terms.
- The language in the agreements often does not clearly state exactly what the County will pay for. For example, the agreements indicate that the County will reimburse PACLAC for providing ushering and building maintenance services, but do not specify what kinds of expenses (e.g., office supplies, postage, training, guest parking, etc.) will be reimbursed.
- PACLAC charged various expenses such as parking, memberships, depreciation, travel, and catering to County-funded operations. Although PACLAC indicated that the expenditures are related to the services provided under the agreements, it's not clear if these expenditures are eligible for County reimbursement.

County management needs to determine what costs the County desires to fund, and amend the leases and agreements with PACLAC to clearly indicate the nature of such costs. To ensure the terms are clear, we also recommend that the County create amended agreements that consolidate and replace prior agreements, to the extent practical.

**Recommendations****County management:**

3. **Create amended leases and/or agreements with the Performing Arts Center of Los Angeles County that consolidate and replace prior agreements, to the extent practical.**
4. **Ensure the leases and agreements with the Performing Arts Center of Los Angeles County clearly indicate the nature of costs the County will reimburse.**

**County Funding**

The leases and agreements between PACLAC and the County require PACLAC to provide the County with a written estimate of the amount needed to perform the County's obligations (i.e., maintenance, security, etc.) for the ensuing year. The leases and agreements also require PACLAC to bill the County monthly in arrears for reimbursement of actual costs for providing the services.

**Summary of County Funding**

For the three fiscal years reviewed, the County provided between \$22 and \$25 million annually to fund Music Center operations. As summarized in the chart below, the County paid an average of \$17.1 million of the total annual funding to PACLAC. The remaining amounts were paid directly by the County to the service provider.

**County Funding for Music Center Operations  
FY 2012-13 through 2014-15**

<b>Description</b>	<b>FY 2012-13</b>	<b>FY 2013-14</b>	<b>FY 2014-15</b>	<b>Percent Change</b>
Administrative Overhead	\$ 605,000	\$ 616,000	\$ 1,123,000	85.6
Usher Services	2,633,000	2,683,000	2,987,000	13.4
Custodial Services	1,835,000	1,870,000	2,031,000	10.7
Insurance	1,046,000	1,066,000	1,078,000	3.1
Security Services	4,953,000	5,048,000	5,103,000	3.0
Engineering Building Maintenance	4,520,000	4,606,000	4,657,000	3.0
Landscaping Grounds Maintenance	485,000	494,000	499,000	2.9
First Aid	71,000	72,000	73,000	2.8
Arts Funding	-	-	1,140,000	
<b>TOTAL PAID TO PACLAC</b>	<b>\$ 16,148,000</b>	<b>\$ 16,455,000</b>	<b>\$ 18,691,000</b>	<b>15.75<sup>1</sup></b>
Utilities (paid directly by the County to utility companies)	5,404,000	5,404,000	5,403,000	0
Other costs not paid to PACLAC	827,000	887,000	964,000	16.6
<b>TOTAL COUNTY BUDGETED EXPENDITURES</b>	<b>\$ 22,379,000</b>	<b>\$ 22,746,000</b>	<b>\$ 25,058,000</b>	<b>11.97</b>

Note: The above chart does not include County funding for Grand Park or for capital projects.

The amount listed above as "Total Paid to PACLAC" is the actual funding the County paid to PACLAC based upon PACLAC's budgeted expenditures. We noted the following issues with the budgeting and payment methods:

<sup>1</sup> The \$18,691,000 paid to PACLAC in FY 2014-15 includes \$1.1 million in pass-through arts funding that PACLAC paid to the Los Angeles Philharmonic Association and the Los Angeles Opera. After excluding the pass-through funding, the total increase of amounts paid to PACLAC over the three-year period is 8.7%.



- The County pays PACLAC its entire annual budgeted amount at the beginning of each fiscal year, rather than on a monthly reimbursement basis (based on actual expenditures), as the agreements require. PACLAC management indicated that the County previously agreed to pay PACLAC the entire annual budgeted amount at the beginning of each fiscal year to meet PACLAC's cash flow needs. Although an annual Board of Supervisors resolution authorizes the County to make an advance payment to PACLAC, the written agreements have never been amended to modify the agreements for this practice. The County should work with PACLAC to analyze PACLAC's cash flow needs and, if the County decides it is appropriate to pay all or part of the annual funding at the beginning of each fiscal year, the County should consider amending the relevant agreements with PACLAC to clarify the revised payment methodology.
- The annual budget submitted to the County by PACLAC is based on the prior year's budget with various adjustments, rather than derived from the anticipated actual costs to provide services. As a result, the budget may not be a good indicator of actual costs.

As noted above, PACLAC does not provide an annual accounting summarizing the use of County funds to show how the funds advanced by the County were spent. In addition, neither PACLAC nor the County reconciles actual to budgeted costs to determine if there are any unspent funds that should be returned to the County.

### **Recommendations**

#### **Performing Arts Center of Los Angeles County management:**

5. **Ensure the annual budget submitted to the County reflects anticipated costs to provide County-funded services.**
6. **Provide the County with an annual accounting of how County funds were spent, and return unspent funds, if any.**

#### **County management:**

7. **Work with the Performing Arts Center of Los Angeles County to determine the appropriate timing of payments, and consider amending the relevant agreements to clarify the revised payment and annual reporting methodology.**

### **Tracking Use of County Funds**

During our review, PACLAC provided reports showing expenditures made from various accounts that were either partially or fully funded with County revenue, such as the accounts for Security and Safety. However, some of the accounts included revenue from other sources, such as reimbursement from third parties for services PACLAC staff

provided. As a result, we were unable to determine if specific expenditures from those accounts were made using County funding or revenue from other sources.

We also noted that PACLAC moved County revenue between various County-funded operations to cover actual expenditures in those accounts. For example, in FY 2014-15, the County paid PACLAC \$1,078,000 for Insurance and \$2,978,000 for Ushers in accordance with PACLAC's budget. However, PACLAC's accounting records indicate expenditures and County funding of \$910,697 for Insurance and \$3,380,000 for Ushers. County management should evaluate if it is appropriate for PACLAC to move County funding among various County-funded operations, and if the movement requires County approval.

Overall, PACLAC's accounting records indicate that their expenditures for County-funded services exceeded the total amount the County paid. However, as noted under the Allowable Expenditures section of this report, it is not clear if all expenditures meet the criteria for County reimbursement.

### **Recommendations**

#### **Performing Arts Center of Los Angeles County management:**

- 8. Revise their accounting methods to enable the tracking of individual expenditures to County funding.**

#### **County management:**

- 9. Evaluate if it is appropriate for the Performing Arts Center of Los Angeles County to move County funding among various County-funded operations, and if the movement requires County approval.**

### **Allowable Expenditures**

The leases and agreements with PACLAC indicate that the County will reimburse PACLAC for their costs to provide custodial, groundskeeping, ushering, security, and general facilities maintenance services. PACLAC contracted for some of these services and provided other services in-house. We reviewed expenditures for services provided in-house as well as those contracted out to ensure they were eligible for County reimbursement based on the leases and agreements between PACLAC and the County. As noted previously, we had difficulty identifying eligible expenditures due to insufficient clarity of the reimbursement language in the leases and agreements. However, we noted questionable expenditures in various areas, as discussed in the following sections.

### **Administrative Overhead**

For the three fiscal years reviewed, annual County funding, ranging from \$605,000 to \$1.12 million, paid for portions of PACLAC's overhead expenses. Overhead costs

include central administrative services such as accounting and human resources, and corporate governance such as the President's Office and the Music Center Board Chair's Office.

Based on the leases and agreements between the County and PACLAC, the County has no obligation to reimburse PACLAC for their administrative overhead expenses. In addition, PACLAC's agreements with the Resident Companies indicate that PACLAC will provide central administrative services and corporate governance in consideration of rents and fees the Resident Companies and their licensees pay.

If County management determines that it is appropriate to continue to reimburse PACLAC for a portion of administrative overhead, County management should establish a method by which overhead is charged to the County. PACLAC's current methodology does not identify the portion of overhead that is attributable to County-funded operations, or identify what types of expenditures can be included in overhead allocated to the County. This could result in the County paying more than its share of overhead and/or paying for items not eligible for County reimbursement. County management should consider the following when determining the portion of overhead, if any, the County will pay:

- PACLAC's corporate governance overhead includes expenditures for the PACLAC President's Office and the Music Center Board Chair's Office. Total expenditures for the three-year period reviewed included items such as \$234,000 for search firm fees, \$7,000 for business gifts, \$53,000 for catering, \$3,700 for donor recognition, and \$102,000 for business/employee meetings. Corporate governance expenditures also included PACLAC's president's salary and benefits, which totaled \$856,000 in calendar year 2013.
- Although central administrative services overhead includes items that appear to be typical business expenditures such as office supplies and accounting staff salaries, we also noted expenditures that do not appear appropriate for inclusion in overhead allocated to the County. For example, for the three-year period reviewed, we noted expenditures such as \$14,200 for employee meetings, \$332,000 for audit fees, and \$746,800 for legal fees.
- It should be noted that PACLAC charged some overhead-type costs, such as telephone, computer software, and office supplies, directly to County-funded operations, so those costs were not included in overhead calculations.

We also noted that the portion of the County's annual payment that was identified in PACLAC's budget as overhead was recorded in PACLAC's accounting records as Marketing, Patron Experience, and Booking revenue. PACLAC management indicated that, since PACLAC charges Resident Companies for overhead, recording County funding as reimbursement for overhead would reduce the portion of overhead that Resident Companies pay. Therefore, PACLAC and the Resident Companies agreed that PACLAC should use the County's overhead funding for marketing/enhancing patron experience instead. We question the appropriateness of recording the County's

funding for overhead expenditures as revenue for non-County-funded operations. At a minimum, this accounting lacks transparency, since PACLAC's accounting records do not show that the County reimbursed PACLAC for part of their overhead expenditures.

We also reviewed 20 administrative overhead expenditures that were partially allocated to the County to ensure they were appropriate and properly supported. We noted that the 20 expenditures had appropriate supporting documentation. However, four (20%) of the expenditures, totaling \$52,321, did not appear to be appropriate to be paid with County funds. The four expenditures included purchases for gift cards, business entertainment such as a holiday party and Board retreat, and catering services for a Board meeting. PACLAC management should ensure that expenditures for items such as gifts, business entertainment, and meals are not allocated to the County as part of overhead.

### **Recommendations**

#### **County management:**

- 10. Determine whether the County desires to reimburse the Performing Arts Center of Los Angeles County for a portion of their administrative overhead expenditures, separate from administrative expenditures that are already charged to County-funded operations as direct expenses.**
- 11. If County management agrees to reimburse the Performing Arts Center of Los Angeles County for overhead, determine a mutually agreeable method for allocating overhead to the County.**

#### **Performing Arts Center of Los Angeles County management:**

- 12. Ensure expenditures such as gifts, business entertainment, and meals are not allocated to the County as part of overhead.**
- 13. Record County funding for administrative overhead in the appropriate overhead accounts in the Performing Arts Center of Los Angeles County's accounting system.**

### **Other Expenditures**

We also noted that the County reimbursed PACLAC for various expenditures that, in accordance with the leases and agreements, should be borne by PACLAC. PACLAC management indicated that the County has been paying for these expenditures for many years, and that, in some cases, the agreement terms are based on outdated business practices. We noted the following questionable expenditures during the three-year period reviewed:

- The County paid PACLAC \$3.2 million for insurance and \$216,000 for first aid. Although the CEO approved PACLAC's proposed budget that included these expenses, the leases and agreements require PACLAC to maintain insurance at no cost to the County, and first aid is not identified as payable from County funding. PACLAC management indicated that approximately 50% of the insurance was for property insurance, which is the County's responsibility. However, although PACLAC management indicated that the County previously requested PACLAC to procure property insurance on the County's behalf, there is no record of this agreement. We also noted that PACLAC's agreements with Resident Companies indicate that PACLAC will provide first aid in consideration of rent the Resident Companies and their licensees pay.
- PACLAC charged \$96,900 to County-funded operations for telephone and communication services. However, the leases and agreements with PACLAC specifically state that the County will not reimburse PACLAC for telephone and communication services. PACLAC management indicated that these terms are outdated and were carried over from the time the County provided services that PACLAC now provides (e.g., security, ushering, etc.), at which time the County provided their own telephones.
- County-funded costs for security operations included \$117,100 for items that the agreements state will be provided by PACLAC at no cost to the County (e.g., office supplies, etc.).
- Legal fees totaling \$135,800 were charged to the County as part of security services, and, as noted previously, a portion of an additional \$746,800 in legal fees was allocated to the County as part of administrative overhead. However, based on the leases and agreements, the County is not responsible to pay for PACLAC's legal fees, except in cases of the County's gross negligence. In addition, the agreements between PACLAC and the Resident Companies state that PACLAC will provide legal support for the Music Center in consideration of rent the Resident Companies pay.

PACLAC also charged various expenses such as guest parking (\$59,800), memberships and dues (\$17,300), travel (\$5,600), catering (\$6,600), and depreciation (\$51,700) to County-funded operations during the three-year period reviewed. Although PACLAC indicated that the expenditures are related to the services provided under the agreements and are a cost of doing business, it's not clear if these expenses are eligible for County reimbursement.

### **Recommendations**

#### **County management:**

- 14. Ensure the County only reimburses the Performing Arts Center of Los Angeles County for agreed-upon expenditures.**

- 15. Ensure that County staff analyzes the costs the Performing Arts Center of Los Angeles County is charging to County-funded operations to determine which costs the County should reimburse to the Performing Arts Center of Los Angeles County.**

### **Salaries**

During the three-year period reviewed, PACLAC spent approximately \$30 million of County funding on salaries and employee benefits for employees who provided services such as security, building maintenance, and ushering.

PACLAC processes timecards on a weekly basis and uses a payroll contractor for payroll processing. PACLAC requires employees to complete manual or electronic timecards. Supervisors or managers review the employee timecards and submit the approved timecards to the Payroll Office for data-entering/uploading in the contractor's payroll system. Payroll Office staff also enter information in the contractor's payroll system for new employees and salary changes.

We reviewed payroll and personnel records for 48 employees whose salaries were charged to County-funded operations and noted the following:

- Two (4%) of the 48 employees worked in administrative operations, but the employees' salaries and benefits were charged to County-funded operations. The employees' salaries should have been charged to administrative operations and allocated as part of administrative overhead.
- Four (8%) of the 48 employees received an additional \$25 as a holiday gift on their paychecks. However, holiday gifts do not appear to meet the criteria for County funding.
- One (2%) of the 48 employees received overtime pay but did not work overtime according to the employee's timecard.

We also noted that PACLAC does not adequately separate personnel and payroll functions. Two payroll employees have the ability to create new employee profiles in the payroll system, process timecards and salary changes, and receive/distribute manual paychecks. As a result, there is a risk that staff could make unauthorized entries in the payroll system. PACLAC indicated that, as a compensating control, a manager independent of the payroll and personnel functions reviews weekly reports of personnel changes such as new employees and salary changes to ensure the changes appear reasonable. However, PACLAC could strengthen their controls by reviewing documentation supporting all new hires and salary changes entered into the payroll system to verify these entries are appropriate.

**Recommendations****Performing Arts Center of Los Angeles County management:**

- 16. Ensure salaries and benefits for administrative staff are charged to administrative operations and allocated as part of overhead, and not charged to County-funded operations.**
- 17. Ensure County funds are not used for employee gifts.**
- 18. Ensure overtime is paid only when the employee actually worked overtime.**
- 19. Strengthen the weekly personnel and payroll review process to include a review of the documentation supporting all new hires and salary changes that were entered into the payroll system.**

**Purchasing/Contracting Controls**

PACLAC contracts with vendors to provide ongoing custodial, landscaping, and elevator maintenance services. PACLAC also has short-term contracts for as-needed services such as painting and wood maintenance.

The County's agreements with PACLAC for the Music Center's original campus indicate that, in the event PACLAC contracts for the provision of services, PACLAC should solicit proposals and select contractors in accordance with standards and procedures acceptable to the County. In addition, PACLAC is required to submit requests for proposals (RFP) and contracts to the County for review and approval. For WDCH, the agreements require that contracts having a term of more than three years be filed with the County for approval.

**Procurement Procedures**

We reviewed PACLAC's procedures for procuring supplies and services and noted the following:

- PACLAC does not have written procurement or contract solicitation policies and procedures.
- PACLAC does not submit RFPs (or other solicitation documents) or contracts to the County as required, and the County has not been requesting these documents.
- PACLAC only issues RFPs to pre-selected vendors. As a result, other potentially qualified vendors do not have the opportunity to submit a proposal. In addition, PACLAC uses only union vendors for certain services (e.g., painting, plumbing,

etc.). Therefore, PACLAC may not be obtaining the best services for the best price.

- PACLAC's contract for custodial services dates back to 1999. PACLAC indicated that they issued an RFP in 2002, but decided to extend the existing contract since the incumbent contractor was the winning bidder. However, because PACLAC was unable to provide documentation of the RFP results, we were unable to confirm that the incumbent contractor won the bid. To obtain the best prices and service, good business practices dictate that bids be solicited more frequently.
- PACLAC did not issue an RFP for services (landscaping services at WDCH) for one (33%) of the three subcontracts reviewed. Although the WDCH agreements do not appear to require a competitive bidding process, it is good business practice to obtain bids/quotes to ensure PACLAC obtains the best service and price.
- We reviewed five purchases and noted price quotes were not obtained for four (80%) of the purchases, totaling approximately \$180,000. According to PACLAC management, quotes were not obtained because the selected vendors were able to meet PACLAC's deadlines, had the lowest hourly rate, etc. However, PACLAC was unable to provide documentation to support the deadlines, and how they determined hourly rates were lower without a competitive quote, etc.

### **Recommendations**

#### **County management:**

- 20. Require the Performing Arts Center of Los Angeles County to submit solicitation documents and contracts for review and approval.**

#### **Performing Arts Center of Los Angeles County management:**

- 21. Create procurement and contracting policies and procedures, and distribute to staff.**
- 22. Submit requests for proposals and contracts to the County for review/approval.**
- 23. Solicit proposals and select contractors in accordance with standards and procedures acceptable to the County. For other purchases and the Walt Disney Concert Hall services, request bids/quotes to ensure the best service is obtained for the best price.**
- 24. Ensure documentation is maintained for all bids/quotes, and to support the Performing Arts Center of Los Angeles County's justification for not obtaining quotes.**



**Vendor Payment Controls**

We reviewed a sample of payments to vendors to determine whether the goods/services were properly procured and documented, and noted the following:

- PACLAC did not always formally amend agreements with subcontractors to reflect increases to contract prices and/or extend contract periods. Of the 12 subcontractor expenditures reviewed, five (42%), totaling approximately \$70,500, exceeded the contract price. For two (40%) of the five, the contract term was not extended to cover the period services were provided.
- PACLAC staff did not properly review subcontractor invoices before payment. For example:
  - We noted an overbilling of \$168 for one invoice. The subcontractor confirmed the overbilling and noted that the previous 26 monthly invoices also contained overbillings totaling \$4,400. PACLAC staff should have detected the overbilling by comparing the subcontractor's invoices to the contract terms.
  - PACLAC approved/paid subcontractor invoices before services were rendered. For two (17%) of the 12 subcontractor expenditures reviewed, totaling approximately \$173,200, PACLAC approved the monthly service invoice before the month began, and approved an additional three (25%) invoices, totaling approximately \$55,600, before the service month ended. Four (80%) of the five invoices that were approved in advance were paid up to 25 days before the service month ended.
- PACLAC does not require employees to maintain packing slips/receiving documents for purchases, and only issues purchase orders to vendors that require them. We reviewed 15 purchases for goods and noted that 14 (93%) did not have a packing slip or purchase order. As a result, accounting staff did not perform a key internal control of comparing invoices to purchase orders and receiving documents to verify that the invoices were for authorized purchases at agreed-upon prices or that PACLAC actually received the goods.

**Recommendations****Performing Arts Center of Los Angeles County management:**

- 25. Amend agreements with subcontractors to accurately reflect revised terms such as increased contract price, extended term, etc.**
- 26. Ensure staff properly review invoices and pay vendor invoices after services have been rendered.**

27. Ensure staff issue and retain purchase orders and maintain documentation to support the receipt of goods and services.
28. Require Accounting staff to match vendor invoices to purchase orders and receiving documentation to ensure the Performing Arts Center of Los Angeles County pays only for authorized purchases at agreed-upon prices and that the goods were received.

### **Facility User's Fees**

In 1979, the County Board of Supervisors approved the implementation of a 5% Facility Fee on all tickets sold at the Music Center, to reduce the amount of money needed from the County's General Fund to pay for repair and replacement of furnishings and fixtures at Music Center facilities. Subsequent leases and agreements for the WDCH also included provisions for a 5% Facility Fee. Resident Companies are responsible for collecting Facility Fees and remitting them to PACLAC. During the period reviewed, PACLAC received Facility Fees totaling approximately \$3 million annually.

The 1979 Board of Supervisors' memo implementing Facility Fees states that the County will maintain budgetary control over Facility Fees. In addition, the WDCH lease states that PACLAC should spend the fees only after obtaining the County's approval.

Our audit scope did not include verifying whether Resident Companies paid the correct Facility Fees to PACLAC. However, based on our review of PACLAC's administration of Facility Fees and related County leases and agreements, we noted the following:

- The 1979 Board of Supervisors' memo implementing Facility Fees refers to an agreement to be created between PACLAC and the County specific to Facility Fees. However, PACLAC and County staff have been unable to locate the agreement, and it's unclear if such an agreement ever existed.
- PACLAC does not submit proposed Facility Fee expenditures to the County for approval, as required by the WDCH lease, or include proposed Facility Fee expenditures in budgets submitted to the County for approval, as mentioned in the 1979 Board of Supervisors' memo.
- PACLAC has used or is planning to use \$13 million in Facility Fees to repay bonds used to finance the 2007 Mark Taper Forum renovation. Because there is no formalized process for PACLAC to notify the County of the proposed use of Facility Fees, it is unclear if County management was aware that Facility Fees were being used to help fund the renovation.
- In 2009, the County paid \$3 million in Extraordinary Maintenance funds to PACLAC for "Recovery of FY10 Facility Fee Expenditures" per PACLAC's invoice. The documentation supporting the invoice does not indicate the purpose of the payment, but PACLAC indicated that the County's intent was to provide financial assistance to the Los Angeles Opera. PACLAC indicated they initially

loaned the \$3 million to the Los Angeles Opera, and later used the \$3 million to make bond payments for the Mark Taper Forum renovation. Due to the lack of documentation, it is unclear if County management was aware of this use of County funds.

Due to the issues we noted, we recommend that the County create and execute an agreement with PACLAC to formalize and clarify the requirements for Facility Fee collection, approval, and use.

### **Recommendations**

#### **County management:**

- 29. Create an agreement with the Performing Arts Center of Los Angeles County to formalize and clarify the requirements for Facility User's Fee collection, approval, and use.**

#### **Performing Arts Center of Los Angeles County management:**

- 30. Submit proposed Facility User's Fee expenditures to the County for approval, and inform the County about any other use of the Facility User's Fees, such as to finance renovation projects.**

### **Facility Fee Expenditures**

According to PACLAC, the Resident Companies and PACLAC collectively determine how Facility Fees should be spent and develop agreed-upon project lists. After the purchases are made, the invoices are forwarded to PACLAC's Accounting Section for payment processing.

While it seems appropriate for Resident Companies to provide input to the proposed use of Facility Fees, the County should have final approval of proposed Facility Fee expenditures, as noted above. Therefore, PACLAC should submit the project lists to the County for review and/or approval.

We reviewed a sample of 29 expenditures that PACLAC made using Facility Fees to ensure they met the expenditure criteria (i.e., repair or replacement of furniture/fixtures, etc., to reduce the amount of money needed from the County's General Fund), and noted the following:

- Three (10%) of the 29 expenditures reviewed, totaling \$13,863, were used for staff training, computers for tracking ticket sales, and installation of wireless internet connections, which does not appear to meet the criteria for the use of Facility Fees.
- One (3%) of the 29 expenditures reviewed, totaling \$48,645, was to reimburse a Resident Company for various purchases. A PACLAC manager reviewed and

approved the Resident Company's invoice. However, the documents supporting the Resident Company's invoice (i.e., vendor invoices/receipts) were not submitted to PACLAC's Accounting Section. As a result, Accounting Section staff processed a payment without reviewing appropriate supporting documentation.

We also noted that five (17%) of the 29 expenditures reviewed, totaling \$219,218, were not on the agreed-upon project lists. PACLAC indicated that projects may change due to changing priorities, and that they regularly communicate with the Resident Companies to ensure they agree with changes to the project list. However, changes to the project list are not documented. In the future, PACLAC should document these changes and ensure that the County agrees with the revised proposed use.

### **Recommendations**

#### **Performing Arts Center of Los Angeles County management:**

- 31. Ensure Facility User's Fee expenditures meet the criteria for using the Fees.**
- 32. Ensure adequate documentation to support Facility User's Fee expenditures is submitted to the Accounting Section for payment processing.**
- 33. Document any changes to Facility User's Fee agreed-upon project lists and obtain County approval for the changes.**



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October 12, 2015  
John Naimo  
Auditor-Controller  
County of Los Angeles  
350 S. Figueroa Street, 8<sup>th</sup> Floor  
Los Angeles, CA 90071

Dear Mr. Naimo:

We are in receipt of the final draft of the Audit of the County General Fund's Music Center Budget for fiscal years 2012 through 2015. The entire Music Center team, including staff and volunteer leadership, highly value our five decades of partnership with the County of Los Angeles. During this time, The Music Center has experienced a tremendous expansion of its work to manage and operate the outstanding county-owned venues that are home to some of the world's leading performing arts companies.

Our management team has worked cooperatively with the County in its audit of The Music Center's contracted work, which governs county-owned facilities, including the Walt Disney Concert Hall, Mark Taper Forum, Dorothy Chandler Pavilion and Ahmanson Theatre. During the auditing process, we provided extensive amounts of information to your staff, including details on our complex operating structure that has changed significantly over the years.

First, we appreciate the Auditor's acknowledgment that the County CEO and the Supervisors approved the detailed budgets we submitted, as well as the recognition that the County is not fully reimbursing The Music Center for the overall costs of operating The Music Center facilities. These findings underscore the need to amend the old agreements to include longstanding County-approved expenditures, such as insurance and administrative overhead.

We also appreciate and support the Auditor's overall conclusion that the agreement and related amendments between the County and the Performing Arts Center of Los Angeles County (PACLAC) warrant revisions to reflect actual business practices. These practices, which were developed in concert with County staff, have evolved over the past 50 years. For example, the current agreement dates back to 1963 and was later amended in the late 1970s. These agreements do not reflect additional services requested since then by the County, nor do they recognize the organizational, financial and governance structure that was put in place at The Music Center in the late 1990s.

The Music Center has reviewed carefully the recommendations in the draft Audit, and we are prepared to work with the County to revise the agreements and business practices accordingly. We have some comments to the findings that form the basis of those recommendations, which follow.

County Oversight and Management

We agree that given the County's investment in the operation of The Music Center, it would be ideal to designate staff to work closely with us to monitor the agreements and spending. We also welcome the opportunity to provide an annual accounting of our County funding as we are diligent in our efforts to ensure that it is used for its intended purpose; importantly, the audit recognizes that our annual spending in these operational departments exceeds the amount of the funding provided by the County. We also appreciate the County's recognition of our unique cash-flow needs and its long-standing practice of providing full funding for our services at the beginning of each fiscal year. Specifically:

- Maintenance of the theatres and the grounds must occur when the theatres are dark – typically in the summer months and between long runs of shows – creating uneven cash-flow needs.
- The use of ushers and security staff fluctuates dramatically throughout the year depending on the performance schedules of our Resident Companies.
- We purchase property and liability insurance for the County-owned theatres, a nearly \$1 million expenditure, upfront for the entire year.

Leases/Agreements between County and PACLAC

As noted, there are multiple areas where current practice differs from terms in the leases and agreements between PACLAC and the County. Oral agreements have been made with the County CEO over the years to include these expenditures in our annual budgets, and the budgets have been approved and funded by the County each year. We agree with the recommendation that the agreements be updated to reflect the current practice.

County Funding

Summary of County Funding

For more than a dozen years our annual budget submission to the County has been based on the prior year's budget, increased by the year-over-year increase in the December CPI along with other adjustments for unavoidable cost increases such as a change in the minimum wage, legislated increases in benefits, and for additional staff or services required to operate the facilities. Historically, each year we prepare and submit a thorough justification to the County for any proposed increases over and above the annual CPI increase as part of our annual budget submission.

In these low inflation years, in particular, the increases in our annual County funding based on this budgeting practice have not been sufficient to cover the actual costs of operating the County-funded services. For example, certain staff are covered by collective bargaining agreements, and we have a contractual obligation to pay negotiated increases in salaries and benefits in accordance with the agreements. These increases have exceeded the increase in the CPI for a number of years.

We embrace the County-Auditor's recommendation to amend our long-standing current budgeting practice based on CPI increases to one that reflects our actual anticipated costs to provide County-funded services.

Tracking Use of County Funds

Working in close coordination with the County CEO's office, historically we have allocated County revenue between various County-funded departments due to the timing of the budget cycle and the nature of our business. The budget cycle begins approximately nine months before the beginning of our fiscal year and, as such, we face several challenges in budgeting for specific expenditures:

- We do not have final performance schedules for the theatres from our Resident Companies at the time of our budget submission. Contracting for third-party rentals and setting the final schedule for the Music Center's programming is dependent on receiving this information, which is the basis for determining our staffing needs and costs.
- Other than ongoing preventative maintenance, special maintenance needs cannot always be anticipated this far in advance.
- We have only five months of actual results for the previous fiscal year at the time of the budget submission.

As noted in the audit report, PACLAC's overall expenditures for County-funded services exceed the total amount the County allocates. Given the nature of our operations, it is important to retain the flexibility of allocating funds between the various County-funded operations. We can submit an annual accounting of the actual expenditures for each department confirming we have spent the County funding appropriately.

Within certain operating departments, in addition to County funding, the revenue also includes reimbursements from third parties and our Resident Companies for services our staff provides for activities held on the Music Center campus. For example, if we use our Security staff for a special event, we include the reimbursement from the event company within the Security department to offset the cost of providing that service. In many cases, the revenue exceeds the direct cost of the service provided as we include an administrative fee in our invoice to the customer. This benefits the County as it lowers the overall funding requirement for that department. Our accounting records are very detailed, and we track the revenue at a customer level. Per the County-Auditor's recommendation, we will modify our timekeeping and accounting system to enable separating out the staff time related to third-party sources of revenue from that specifically related to County funding.

Allowable Expenditures

In our continued effort for full transparency, we look forward to working with the County to update our contracts to reflect the County's current budgeting and funding practice. With that, we will memorialize the County's acknowledgement that administrative overhead, insurance, and other expenses as described in the audit report are appropriate.

#### Administrative Overhead

PACLAC employs a robust cost-accounting methodology to allocate administrative overhead to ensure that costs are being allocated appropriately. The allocation of central administrative services is based on actual usage of services. For example, overhead related to information technology services is allocated based on the number of computers within each department. These counts are updated annually, and cost allocations are adjusted accordingly. Corporate Governance expenditures, which consist of the President's Office, the Board Chair's Office and Business Affairs, are allocated based on an estimate of time spent by staff in those units. These allocations are reviewed and adjusted annually by The Music Center's CEO.

The administrative overhead allocated to Center Operations, which encompasses the County-funded and other operational departments such as Stage Operations, Booking and Scheduling, and Operations Management, exceeds the funding provided by the County.

We look forward to working with the County to identify allowable expenditures eligible for funding by the County and to arrive at a mutually agreeable reporting method on the use of overhead.

#### Other Expenditures

As noted in the audit report, the County reimburses PACLAC for various operational expenditures that are not identified currently in the existing written agreements as being the responsibility of the County, such as insurance and first aid, and for certain departmental expenditures such as telephones, depreciation and vendor parking. At the time the agreements were executed, the County was directly providing staffing and services at The Music Center and had County systems throughout the complex to support these County departments. As PACLAC took over these services, the intent was for the County to fund fully the newly created PACLAC departments.

We agree that as we update our agreements, we must clearly define all allowable expenditures.

#### Salaries

As with all nonprofit companies, we carefully control our back-office and overhead expenses and, as such, have a very small but efficient payroll department. We agree that this critical function must have appropriate checks and balances and will review and formalize our processes, as necessary, to strengthen internal controls. In addition, as we modernize our County agreements we will work with the County to determine how salaries and benefits for administrative staff within County-funded departments are charged.

#### Purchasing/Contracting Controls

The Music Center is committed to best practices for a performing arts center in all of its activities, including purchasing and contracting for goods and services. In some cases these standards are unique to our industry. In updating our contractual agreements, we look forward to working with the County to document these practices and submit to the County solicitation documents and contracts for review and approval whenever practical.



Procurement Procedures

We agree to formalize a procurement procedure that both satisfies the County requirements and our unique circumstances. However, occasionally we need to make same-day contracting decisions to meet our operational obligations to the County; preparing a written RFP in all situations would prove to be extremely challenging. For example, if a piece of equipment fails and needs to be replaced for a performance that night, we do not have the ability to go through the RFP process and submit the request to the County as recommended.

Vendor Payment Controls

We will work with appropriate staff on the formalization and implementation of our procurement procedures. We will also work with our vendors to ensure that invoice and contract terms are consistent.

Facility Fees

When the County established the Facility Users Fee in 1979, it was with the understanding that a certain level of funding is required to maintain these magnificent County facilities. This extraordinary source of funds is used to help keep our theatrical equipment current and the public spaces in excellent condition. We work very closely with our Resident Companies to prioritize the use of these funds. Recognizing the ever-changing needs of facility fee use, in the current long-term license agreements with our Resident Companies, which were approved by the County, we have defined procedures and appropriate uses of facility fees. However, we agree with the audit recommendation to create a separate agreement with the County to formalize and clarify the requirements for facility fee collection, approval, and use.

In conclusion, Mr. Naimo, we appreciate the time and effort the auditors invested in this process and look forward to working with our partners in the County to modernize the agreements in accordance with the recommendations in the audit. I speak for everyone at The Music Center and wish to convey to you how honored we are to be a longstanding partner with the County of Los Angeles, which continues to entrust us with the important stewardship role of managing all of the wonderful Music Center facilities.

Sincerely,



Howard Sherman

Executive Vice President and Chief Operating Officer

cc: The Music Center Board of Directors  
Rachel S. Moore, President and CEO  
Lisa Whitney, Senior Vice President and CFO